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Rating Action: Moody's downgrades ratings of Integrys Energy and its subsidiaries; rating outlook is negative

Global Credit Research - 09 Jun 2009

New York, June 09, 2009 -- Moody's Investors Service downgraded the senior unsecured rating of Integrys Energy Group, Inc. (Integrys) to Baa1 from A3. Moody's also downgraded the long-term ratings of Integrys' subsidiaries including Peoples Energy Corporation's (PEC) senior unsecured rating to Baa1 from A3, Wisconsin Public Service Corporation's (WPSC) senior secured rating to A1 from Aa3 and Issuer Rating to A2 from A1, The Peoples Gas Light and Coke Company's (PGL) senior secured rating to A2 from A1 and North Shore Gas Company's (NSG) senior secured rating to A2 from A1.

Separately, Moody's confirmed the commercial paper rating for WPSC at Prime-1 and downgraded PGL's commercial paper rating to Prime-2 from Prime-1. These rating actions conclude the review for possible downgrade that commenced on March 9, 2009. The rating outlook for Integrys, PEC, WPSC, PGL and NSG is negative.

PEC is an intermediate holding company and its rating is based upon the unconditional guarantee of payment by Integrys. WPSC, PGL and NSG are wholly-owned free-standing regulated utility subsidiaries of Integrys.

"Today's rating actions considers management's decision to divest its significantly sized non-regulated energy marketing business and focus on improving the financial performance of its various utility subsidiaries", said Moody's Vice President Scott Solomon. "While Integrys' business risk and liquidity profiles are expected to improve after the divestiture, management will be challenged to offset the loss of earnings that this business generated", continued Solomon. Moody's estimates that the energy marketing business generated approximately 20% of Integrys' consolidated CFO pre W/C during 2008.

The rating action is tempered by Integrys' commitment to reduce its debt by as much as a \$600 million with capital it expects will be returned through a divestiture or rationalization of its non-regulated businesses.

The negative outlook reflects execution risk and uncertainty associated with the divestiture process. While Integrys has announced its intent relating to this business, a transaction has yet to materialize. Moody's would likely revise the outlook to stable should we gain comfort with the company's ability to complete the sale and achieve its debt reduction target; however, additional rating pressure could result if the divestiture and debt reduction targets are not close to being met by mid-year 2010.

Going forward, Integrys' regulated subsidiaries are expected to file more frequently for rate relief while focusing on cost control, actions that, if successful, should provide incremental cash flow and earnings. In 2008, the company's regulated subsidiaries completed 5 rate cases with plans for a similar amount in 2009. Near-term rate relief may become more of a challenge given current economic conditions.

Today's rating action also reflects management's decision to leave its dividend policy unchanged in light of expected near-term reductions in earnings and internal cash flow generation. Integrys' common dividend, which is expected to be no less than 85% of consolidated net income through 2011 compared to its approximately 70% historical pay-out ratio, will continue to exceed the amount of funds provided by its regulated utility subsidiaries thus necessitating the issuance of additional debt at the holding company.

The Baa1 reflects an expectation that Integrys will maintain consolidated CFO pre W/C to adjusted debt and CFO pre-W/C interest coverage in the range of 16-20% and 4.0-4.5 times metrics, respectively, which we view as appropriate for a high-Baa rating. Integrys' ability to achieve metrics within these stated ranges, however, is largely dependent on the success of meeting its debt reduction target. Moody's prior ratings had assumed that Integrys' would achieve consolidated metrics of CFO pre-W/C to debt and CFO pre-W/C interest coverage of more than 20% and 5 times, respectively.

The one notch downgrade for the regulated utilities reflects the risk that their internal cash flow could be pressured to support Integrys' continuing cash needs and that near-term financial metrics will be negatively impacted by reduced demand for energy.